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No. 834

In the Supreme Court of the United States

OCTOBER TERM, 1959

OLDHAM CLARKE, TRUSTEE FOR DENTON, FRANK FEHR BREWING CO., PETITIONER,

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (R. 29a–38a [1]) is reported at 160 F. Supp. 631. The *per curiam* opinion of the court of appeals is reported at 274 F. 2d 824.

JURISDICTION

The judgment of the court of appeals was entered on January 15, 1960. The petition for a writ of certiorari was filed on April 4, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

[1] "R." refers to the appendix to the petitioner's brief in the Sixth Circuit. "Supp. R." refers to the separate appendix to the Government's brief in the Sixth Circuit.

QUESTION PRESENTED

Whether the two courts below were correct in finding that the income tax returns of the taxpayer corporation for the years 1948 through 1952 were fraudulent and therefore that the claim of the United States for delinquent taxes and interest is not barred by the statute of limitations.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * * *

(26 U.S.C. (1952 ed.) 275)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * * *

(26 U.S.C. (1952 ed.) 276)

STATEMENT

The Frank Fehr Brewing Company, the taxpayer, filed a voluntary petition for a corporate reorganiza-

tion under Chapter X of the Bankruptcy Act, c. 541, 30 Stat. 544, as amended. The United States filed a claim—pursuant to an order in the bankruptcy court requiring all creditors of the Company to file their claims—for additional federal corporate income taxes and interest assessed against the taxpayer for the years 1948 through 1952. After a three-day trial, at which eleven witnesses testified, the district court made the following findings of fact:

Colonel Frank Fehr was president of the taxpayer corporation during the years in question and Fehr Kremer, his nephew, was executive vice-president and director of sales and advertising. Fehr Kremer was also secretary until September 1950, when his son-in-law was elected secretary (R. 31a). These two men, who owned the majority of the common stock of the taxpayer, also served on the board of directors (R. 30a–31a) whose election they controlled through common stock ownership and the proxy mechanism (R. 7a–10a). Arlie Chastain, who was comptroller and chief bookkeeper for the corporation from 1935 to 1955, usually prepared and signed checks drawn on the bank accounts of the corporation during this period [2] (R. 31a).

The tax returns filed by the taxpayer for each of the tax years 1948 through 1952 contained deductions for personal expenses of Colonel Fehr, his wife, Fehr Kremer, and the latter's family, which were charged as business expenses, thereby reducing

[2] It was required that all checks be signed by any two of the following officers: Fehr, Kremer, Chastain, and Petot, the treasurer (R. 31a).

the net income reported in each of the years in question (R. 33a, 39a–43a). These deductions included in each of the tax years 1948 through 1952: checks issued by the taxpayer for the expenses of Colonel Fehr and his wife on trips to Florida; substantial payments made by the taxpayer to the Madrid Garage for the upkeep and storage of a Cadillac and a Lincoln automobile furnished to Colonel and Mrs. Fehr; and meals frequently eaten by Fehr Kremer at the Brown Hotel, alone or with members of his family. On each of Fehr Kremer's trips to Florida, extensive entertainment was charged to the taxpayer, even though these occasions were not attended by customers, prospective customers, or suppliers of material to the taxpayer (R. 33a–35a).

In addition, the following personal expenses were deducted in the individual tax years: in 1949, the expenses of Fehr Kremer, his wife, his daughter, and his son-in-law on a trip to Florida, and the cost of a television set for Colonel Fehr; in 1950, a substantial amount for the expenses of Fehr Kremer and his wife while spending a week at the Waldorf-Astoria Hotel in New York City;[3] in 1951, meals eaten by Colonel Fehr and his wife at the Brown Hotel, the salary of Paul Brooks, who accompanied them as chauffeur on their Florida trip, the

[3] This amount was ostensibly for expenses while attending a week-long convention in Philadelphia. In fact, Fehr Kremer attended the convention only one day and his wife did not attend at all. Their expenses at the Waldorf-Astoria were charged to the taxpayer as business, traveling, or advertising expenses (R. 34a).

salary of Reed Terrill, a personal servant to Colonel Fehr and Mrs. Fehr, and the cost of a rowing machine for Fehr Kremer which was installed in his home (R. 34a).

Mr. Kremer claimed that the above deductions were for legitimate expenses for advertising, creating good will, and otherwise furthering the interests of the taxpayer. Yet, both Colonel Fehr and Mr. Kremer knew that the taxpayer had not authorized these amounts to be expended for their personal benefit by any resolution or minutes in its records. Moreover, they also knew that the taxpayer's books, although showing the expenses in general terms, did not disclose their nature as for travel, entertainment, and other personal items as would be required under ordinary bookkeeping and auditing standards. Fehr and Kremer both had this knowledge when the tax returns were made, and the comptroller, Mr. Chastain, had this knowledge when he signed the tax returns for each of the years in question. Thus, while the directors of the company knew of the purposes of these expenditures, these purposes were not disclosed to the Government. Instead, it was represented to the Government that the expenditures were for office, travel, or advertising expenses and were therefore legitimate business expenses (R. 35a–36a).

The district court concluded that the Commissioner had carried the burden, which the court imposed upon him, of showing by clear and convincing evidence that the corporation's federal in-

come tax returns in each of the years 1948 through 1952 contained deductions which were not deductible as proper or necessary business expenses; that the corporate officers who signed and caused the returns to be filed knew that the deduction of substantial amounts claimed in the returns as office, traveling, and advertising expenses in fact represented expenditures for the personal benefit of Colonel Fehr, Fehr Kremer, and their families, and could not properly be considered as expenses of the corporation; that the deductions were fraudulently claimed; and that this fraud tolled the three-year statute of limitations (R. 35a, 37a–38a).

After the district court had ruled that the fraudulent returns had tolled the limitations statute, the parties filed a stipulation of facts (R. 39a–43a) in which the trustee conceded that for each of the years in dispute and for certain additional years the taxpayer had understated its net income by claiming improper deductions including the expenses of Colonel Fehr and Fehr Kremer. The total amount of expenses of Colonel Fehr and Fehr Kremer in the years 1948 through 1952, which it was stipulated should be disallowed, amounted to $115,932.44 (R. 39a–41a). On the motion of the United States for summary judgment, the district court allowed the claim for additional income taxes for the years 1948 to 1952 and the year 1954 in the amount of $117,153.69 and for interest to the date the reorganization petition was filed in the amount of $39,543.44 (R. 51a).

The court of appeals affirmed on the opinion of the district court. 274 F. 2d 824.

ARGUMENT

Section 276(a) of the 1939 Code, *supra*, p. 2, provides that "In the case of a false or fraudulent return with intent to evade tax * * * the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time." The only question presented to the courts below was whether the corporation's income tax returns for the years in issue were false or fraudulent with intent to evade tax. This question, depending on the facts in this particular record, presents no conflict of circuits or other ground warranting review by this Court. Moreover, the issue was resolved correctly by the two courts below.

1. Whether the corporation's income tax returns for the years in question were fraudulent presents a question of fact which must be determined from the entire evidence and surrounding circumstances. See *Bryan* v. *Commissioner*, 209 F. 2d 822 (C.A. 5), certiorari denied, 348 U.S. 912; *Rose* v. *Commissioner*, 188 F. 2d 355 (C.A. 9), certiorari denied, 342 U.S. 850; *Battjes* v. *United States*, 172 F. 2d 1, 5 (C.A. 6); *Eagle* v. *Commissioner*, 242 F. 2d 635 (C.A. 5); *Owens* v. *United States*, 197 F. 2d 450 (C.A. 8). The factual issue of fraud was carefully and thoroughly tried before the district court, which had ample opportunity during the three-day trial to see and hear the eleven witnesses who testified before it and to judge their credibility. An examination of the 211 pages of excerpts from the testimony of the trial, printed as the appendix to the Government's brief in the court of

appeals, demonstrates that the case was vigorously tried before an experienced district judge on behalf of the trustee of the taxpayer and all other parties. Moreover, throughout the trial Fehr Kremer, who has filed a brief *amicus curiae* here, was represented by counsel (Supp. R. 1b). The case was fully briefed and argued by both sides in the court of appeals.[4] After consideration of the record, the

[4] The opinion of the court of appeals, affirming the district court's order, which in turn confirmed a proposed plan of reorganization for the taxpayer, shows that while Fehr Kremer's former counsel withdrew after the judgment was entered in the district court in the present case, his present counsel commenced representation of him at least in the reorganization proceeding on April 24, 1959, long before briefs were filed by either side in the court of appeals in the present case. *In re Frank Fehr Brewing Co.*, 268 F. 2d 170, 175, certiorari denied, *sub nom. Kremer* v. *Clarke*, No. 317 Misc., this Term, petition for rehearing pending. Although Fehr Kremer's present counsel now criticize in their *amicus* brief the trustee's prosecution of the appeal from allowance of the tax claim, they filed no brief in the court of appeals. Moreover, the court of appeals in its decision in the reorganization proceeding stated with respect to the tax claim that "[t]he Trustee is vigorously contesting the liability, but the case is far from being finally decided," and pointed out that, even if the amount of the judgment here obtained by the United States was excluded, the total amount of claims prior to the common stockholders was reduced only to $1,174,626, which the corporation's assets were insufficient to pay. 268 F. 2d at 178.

denied, June 6, 1960

With the exception of the suggestion that the expenditures here involved might now be considered as additional compensation and hence properly deductible, all of the points which Fehr Kremer contends were omitted by the trustee in the court of appeals (*Amicus* Br. 12–19) were in fact raised by him in that court in written or oral argument. As to the new contention, the stipulation of facts makes clear that the expenditures here in question were not considered as compensation at the time they were made (R. 39a–43a).

briefs, and the argument of counsel, the court below affirmed on the opinion of the district court.

The district court's findings were certainly not clearly erroneous. See Rule 52(a) of the Federal Rules of Civil Procedure. The court of appeals found that they were sustained by the record. These concurrent findings are final in the absence of a very exceptional showing of error. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

2. Arlie Chastain, the comptroller of the taxpayer and hence the officer in charge of all accounting, testified in detail with respect to most of the questioned deductions (Supp. R. 4b–54b). Mr. Chastain was one of the officers who signed on behalf of the taxpayer corporation each of the returns for the years in question (R. 35a; Supp. R. 48b–49b). He testified that the facts which might have shown a connection between the expenditures in question and the taxpayer's business were kept within the knowledge of Colonel Fehr, Fehr Kremer, and himself and that Colonel Fehr and Fehr Kremer directed him to charge the disputed expenditures to business expense without substantiation (Supp. R. 4b–9b). Mr. Chastain further stated that at the time he signed the returns he knew that these expenses, being in fact expenditures for the personal benefit of Colonel Fehr, Fehr Kremer and their families, could not properly be considered as expenses of the corporation and that the records of the corporation were maintained in such a way that they did not reveal that the expenditures were actually made for the

personal purposes which are now admitted[5] (R. 35a; Supp. R. 5b–9b, 24b–25b).

C. R. Escott, a senior partner of the accounting firm of Escott, Grogan & Company, which audited the books and records of the taxpayer and prepared its tax returns, testified that he refused to close the audit with respect to the year 1952 until he received specific board approval of Colonel and Mrs. Fehr's Florida expenses in that year which amounted to $7,984.81. He requested board approval to relieve himself of responsibility as an independent accountant. Thereafter, Mr. Escott was notified that the board had expressly approved this item. The audit was closed and the returns filed accordingly. On subsequent investigation, however, he was unable to find any record of the approval in the minutes of the board of directors (Supp. R. 129b–131b). Mr. Escott further testified that, though he admonished the taxpayer's officers to provide substantiation or explanation of the amounts charged to expenses, no improvement was made (Supp. R. 132b, 141b).

John S. Petot, the treasurer and a director of taxpayer from 1936 through 1954, Leo Ross, a purchasing agent of taxpayer, and A. Joseph Zimmer, an audit agent of the Internal Revenue Service, all testified that the corporate books or records contained nothing explaining or substantiating the business purposes for which the expenses were claimed to have

[5] Fehr Kremer in his *amicus* brief (*Amicus* Br. 18) expresses disagreement with the courts below as to the weight to be given to Mr. Chastain's testimony. Such disagreement does not raise a question of law for this Court.

been incurred or even to reveal whether the expenditures in question were connected with the business of the taxpayer. Instead, the expenditures were simply charged to business expense (Supp. R. 108b, 118b–119b, 153b, 161b–162b, 165b, 170b–171b).

On the basis of this and other evidence, the district court found that the corporate officers who signed and caused the taxpayer's returns to be filed knew that the corporation had not authorized the expenses in question by any resolution or minutes in its records and knew that the records of the corporation did not show that the amounts were actually expended for the personal purposes which they now admit. The trial court found that Colonel Fehr and Fehr Kremer each had this knowledge when the tax returns were made and that Arlie Chastain had this knowledge when he signed the tax returns for each of the years in question[*] (R. 35a). In conclusion, the court found from the testimony that these corporate officers knew that the deduction of these substantial amounts claimed as business expenses in fact represented expenditures for the personal benefit of Colonel Fehr, Fehr Kremer, and their families and could not properly be considered as expenses of the corporation (R. 37a).

These actions and knowledge by the taxpayer's officers, coupled with their lengthy business experience and the recurrence of the deductions (R. 39a–

[*] Fehr Kremer co-signed with Mr. Chastain on the returns filed for the years 1948, 1950, 1951, and 1952. Mr. Petot, the treasurer, co-signed with Mr. Chastain on the return filed for the year 1949 (Supp. R. 48b–49b).

43a), are adequate to sustain the district court's further finding that the officers deliberately acted to conceal or misrepresent to the Government the actual facts in order to obtain unallowable deductions. The courts below were warranted in holding that such a deliberate suppression of vital facts constitutes a fraud which tolls the statute of limitations (R. 36a, 38a).

3. It is well settled that the fraudulent intent of a corporate officer signing a return is imputed to the corporation. *Crescent Manufacturing Co.* v. *Commissioner*, decided August 31, 1948 (1948 T.C. Memorandum Decisions, § 48,171), affirmed *per curiam*, 181 F. 2d 185 (C.A. 6); *United Mercantile Agencies* v. *Commissioner*, 23 T.C. 1105, affirmed on other issues *sub nom. Drybrough* v. *Commissioner*, 238 F. 2d 735 (C.A. 6); *Currier* v. *United States*, 166 F. 2d 346 (C.A. 1); *Auerbach Shoe Co.* v. *Commissioner*, 216 F. 2d 693 (C.A. 1); *United States* v. *Peelle Co.*, 137 F. Supp. 905 (E.D. N.Y.); *Saven Corp.* v. *Commissioner*, 45 B.T.A. 343, 355–356; *Summerill Tubing Co.* v. *Commissioner*, 36 B.T.A. 347, 351. Therefore, while Section 52(a) of the Internal Revenue Code of 1939 (26 U.S.C. (1952 ed.) 52) requires that the return be signed by two corporate officers, the circumstance that one of the authorized officers who signs a return does not know that it is false will not relieve the company from culpability, providing that the other officer had knowledge that the return is false. Thus, even if Fehr Kremer or Petot may be deemed to have acted without fraudulent intent, it is plain that the comptroller, Chastain, did have the knowledge that

the deductions were fraudulently claimed and the returns were false with the intent to evade tax.

4. Petitioner and the *amicus* (Pet. 14–15; *Amicus* Br. 16–17) refer to the fact that revenue agents examined the returns in question shortly after they were filed and did not object to the inaccuracy or incompleteness of the records. Surely, this is no defense to the claimed misrepresentations here. As Mr. Chastain testified, the agents who made the audits had only several days in which to do so and they merely looked at the books of the company and spot-checked the supporting vouchers (Supp. R. 53b–54b). The corporate books, however, failed to reflect the nature and purposes of the expenses in accordance with ordinary bookkeeping and auditing requirements (R. 35a) and there is nothing to show that any of the items in question appeared in the spot checks which were made. That the incomplete books, calculated to mislead the revenue agents, succeeded at first affords no defense to the taxpayer.

5. In signing the tax returns, the taxpayer's officers did not rely upon the advice of accountants that the deductions taken were proper. Instead, contrary to the contentions of the petitioner and *amicus* (Pet. 14–15; *Amicus* Br. 16–17), the accountants accepted the officers' representations that the deductions were business expenses despite lack of supporting papers (Supp. R. 126b, 128b-129b, 131b-132b, 134b, 140b-141b). Taxpayer cannot shift the responsibility for the deficiencies to accountants when all necessary information was not turned over to them and when the taxpayer, or its officers, did not seek the advice of

the accountants as to the propriety of the many personal expenditures for Mr. Kremer and Colonel Fehr which were charged to business expense. See *Lashells' Estate* v. *Commissioner,* 208 F. 2d 430, 436 (C.A. 6); *Bender* v. *Commissioner,* 256 F. 2d 771, 774 (C.A. 7); *Mauch* v. *Commissioner,* 35 B.T.A. 617, 627–628, affirmed, 113 F. 2d 555 (C.A. 3).

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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